A. Bell Atlantic Has Not Reasonably Assigned the Costs Associated With Primary Plant Between Video and Telephony, and Bell Atlantic's Rates Do Not Reflect the Incremental Costs of the Video Dialtone Shared Primary Plant.

Bell Atlantic has failed to provide the Commission with its estimate of the total actual construction costs of its Dover video dialtone system. In response to Issue A(2), Bell Atlantic identifies the "total projected costs" for the Dover system as $68,402,434.[46/] Bell Atlantic admits, however, that this amount represents its estimate of the "long run incremental costs" for its video dialtone service in Dover, not its estimate of the actual "capital dollars required to engineer, furnish and install the facilities and equipment required in the build area."[47/] Bell Atlantic implies that its actual construction costs will be greater, perhaps much greater, than the costs it has reported because its actual costs include "expenditures for the placement of excess capacity to support future growth."[48/] For example, Bell Atlantic states that, if its video dialtone service uses only 2 fibers within a 216 fiber sheath, Bell Atlantic has only allocated 2/216th, or less than 1 percent, of the full construction cost of this sheath.[49/] Consequently, Bell Atlantic's figures seriously understate the primary plant costs associated with the Dover system.

Bell Atlantic also skews its cost figures by failing to distinguish between incremental and dedicated costs. In its responses to Issues B(5) through B(6), Bell Atlantic responds to the Commission's request for incremental cost information by providing data concerning dedicated costs. Bell Atlantic identifies certain cost categories as dedicated to video, those dedicated to

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46/ Direct Case at 16.

47/ Direct Case at 4.

48/ Id.

49/ Id.

telephony, and those shared by both. It desegregates the shared categories by identifying components which are dedicated to video, telephony and shared by both.

The distinction between an incremental and dedicated cost is significant. Given an integrated system producing two products, A and B, the incremental cost of A can be determined by subtracting the stand-alone cost of B from the cost of the integrated system. Similarly, the incremental cost of B can be determined by subtracting the incremental cost of A from the cost of the integrated system. Consequently, an economically reasonable method of allocating the costs shared between two services is a ratio of the services' incremental costs.

In Dover, Bell Atlantic's analysis of its shared plant indicates that the per home component costs dedicated to video ($136.61) represents 28 percent of the total per home component costs dedicated to either video or telephone ($482.34). Bell Atlantic's tariff calculations use this ratio to allocate the $1175.10 of per home shared costs not dedicated to either service. However, the actual per home incremental cost of video in a combined video-telephony system, based upon independently developed data, is 72 percent of the total per home incremental costs.[50/] While the details of the data upon which this analysis is based can be contested, there is no question about the study's theoretical reasonableness. Not even Bell Atlantic would contend that a stand-alone telephone network costs more than a stand-alone video network. Theoretically, therefore, the incremental cost of video must be greater than that of telephone in an integrated network. In other words, more than 50 percent of the incremental costs of an integrated network are assignable to video.

50/ See Exhibit 3.

Further, it must be recognized that video dialtone is not merely a new telephone service added to the existing narrowband telephone network. Video dialtone represents an entirely new line of business for the carrier which requires the construction of a wholly new broadband network. To expect video dialtone to cover only its incremental costs is to expect, simultaneously, that telephone service will cover all of the common costs of the integrated system for which video dialtone is largely responsible. Such a result would be a transparent cross-subsidy of video by telephone service.

B. Bell Atlantic's Tariff Demonstrates that the Dover Video Dialtone System Is an Unworkable Business Proposition that Bell Atlantic Seeks for the Commission To Make Viable.

Bell Atlantic's elasticity analysis confirm's Cox's previous showing that the Dover version of video dialtone is not a viable business.[51/] As Cox demonstrated through its prior extrapolation of costs, costs that Bell Atlantic itself now has confirmed, the actual cost of the Dover video dialtone system cannot be recovered from video dialtone users. Exhibit 1 demonstrates that with the adoption of a 50/50 cost allocation method, a method far more generous than the 72 video/28 telephony method that is economically justified, Bell Atlantic will have to raise its rates 53 percent to recover its direct costs and average overhead. Yet, Bell Atlantic's own elasticity analysis, while speculative, suggests that a 53 percent price increase cannot be absorbed by video dialtone programmer customers. If Bell Atlantic believes its own numbers, it must admit that Dover is an uneconomic venture. Bell Atlantic should live up to its own words: "[i]f a new entrant cannot serve a community on an unsubsidized basis, there is no

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51/ See, e.g., Letter to Geraldine Matise, Chief, Tariff Division, Common Carrier Bureau, Federal Communications Commission, from Leonard J. Kennedy, Esq., in Bell Atlantic Tariff F.C.C. No. 10, Transmittal No. 741 (filed May 15, 1995).

justification for ratepayers' funds being used to finance contrived competitive entry that would be uneconomic but for the subsidy."[52]

Exhibit 1 also shows that, if Bell Atlantic is not required to raise its rates to a justifiable level, it will lose nearly $7 million per year on its Dover video dialtone system. Exhibit 4 demonstrates that this loss would increase to over $600 million per year if extended to all locations for which Bell Atlantic originally filed Section 214 Applications. When Bell Atlantic's figures are extrapolated to cover the entire Bell Atlantic service region, its annual losses (to be shared by telephone ratepayers, Bell Atlantic competitors and Bell Atlantic employees, but not likely by Bell Atlantic shareholders) are a staggering $2 billion annually.[53] Perhaps it is because of the magnitude of the potential losses involved that Bell Atlantic has scaled back its ambitious video dialtone expansion plans, even with the rich inducement of a potential cost allocation cross-subsidy. Even if Dover ultimately becomes Bell Atlantic's only video dialtone system, the Commission should still insist that system costs be borne by system users and refuse to allow the misallocation of costs necessary to make the Dover system viable.

C. In Fairness to Bell Atlantic Ratepayers, Employees, Competitors and Shareholders, the Commission Must Recognize that the Majority of Costs Identified as Shared Are Incremental and Must Be Recovered by Video Dialtone.

The deficiency of Bell Atlantic's cost allocation proposal becomes even more vivid when compared with video dialtone cost allocation proposals discussed or adopted in other

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52/ See Comments of Bell Atlantic, supra note 1.

53/ This estimate is conservatively based upon Bell Atlantic's latest submission and a simple ratio of losses per home passed. Previous estimates based on Bell Atlantic's Section 214 Application data indicated potential losses of over $3 billion if extended to all Bell Atlantic households.

jurisdictions. In Canada, for example, the Canadian Radio-television and Telecommunications Commission ("CRTC") recently released a Decision which dealt, in part, with the regulatory treatment of local exchange carrier broadband investments.[54/] Like the Commission, the CRTC "considers it essential that the regulatory treatment of such a large undertaking be fair to consumers and competitors and ensure that shareholders both assume the risks and receive the rewards of their investment."[55/] Consequently, the CRTC Decision results in a framework conceptually akin to the de minimis cost allocation approach the Commission has raised for consideration in its Investigation Order.[56/]

The CRTC Decision states:

54/ Canadian Radio-television and Telecommunications Commission, Implementation of Regulatory Framework -- Splitting of the Ratebase and Related Issues, Telecom Decision CRTC 95-21 (released October 31, 1995) ("CRTC Decision").

55/ Id. at 33.

56/ Under the de minimis approach, a service using shared plant and facilities is not charged for any of the costs of those facilities if the service's level of usage of the shared plant and facilities is de minimis. In Issue A(6) the Commission asked whether a de minimis approach should be adopted for sharing video dialtone system costs between video and telephony, and if so, how de minimis usage should be determined. Bell Atlantic admits in response to Issue A(6) that the application of a 10 percent de minimis criteria to its Dover system would result in the assignment of all shared costs to video dialtone and none to telephony. Direct Case at 22. According to Bell Atlantic's calculations, a minutes of use comparison would allocate 96 percent of shared costs to video dialtone and 4 percent to telephony. A holding time comparison would allocate 95 percent of shared costs to video and 5 percent to telephony.

The Commission notes in the Investigation Order that it has adopted a 10 percent de minimis criteria in other proceedings. Bell Atlantic, however, argues that this approach would lead to absurd results in this case because it would impose all of the costs of the integrated network on video dialtone. Theoretically, there is nothing absurd about this result. Since telephony is served quite well by the existing narrowband network, the entire broadband network can be considered an incremental cost and quite appropriately charged to its cause, video dialtone. From a strictly objective viewpoint, therefore, use of a de minimis approach is eminently reasonable for the limited purpose of allocating shared plant and facilities.

> The Commission finds, that, in general, the most appropriate regulatory treatment for broadband initiatives is to require the telephone companies to assign to the Competitive segment all new investments and related expenses associated with the deployment of fibre, coaxial cable, opto-electrical equipment, asynchronous transfer mode (ATM) switches, and video servers.[57/]
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> * * *
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> Specifically, the Commission considers it reasonable for the telephone companies to charge a transfer price to the Utility segment in those circumstances where Utility segment services, such as basic local service and bottleneck services provided to competitors, are provided through shared use of broadband facilities assigned to the Competitive segment.[58/]
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> * * *
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> In the Commission's view, <u>because the provision of Utility segment services such as basic local telephony does not require the capability inherent in the broadband infrastructure</u>, the transfer price established for such services should be based on the Phase II incremental costs incurred by the Competitive segment to provide these services, with an appropriate mark-up, recognizing that there will be circumstances where the incremental costs are negligible.[59/]
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> The Commission considers that the regulatory treatment set out above best ensures that Utility segment service subscribers do not bear any of the risk associated with new broadband investment. In particular, it ensures that spare capacity that may only subsequently become useful for the provision of new broadband services is not warehoused in the Utility segment. Further, it addresses the need for a fair treatment of such a large investment for competitors and shareholders of the telephone companies.[60/]

To put this framework in a U.S. context, it would be as if the Commission ruled that all broadband network investments would be treated as nonregulated for purposes of Part 64 of the Commission's rules. The carriers would, however, be permitted to charge the telephone segment with the <u>incremental</u> costs of the new network's provision of telephony services. The CRTC

<u>57/</u> CRTC Decision at 34-35.

<u>58/</u> <u>Id</u>. at 36.

<u>59/</u> <u>Id</u>. at 36-37 (emphasis added).

<u>60/</u> <u>Id</u>. at 38.

approach is exactly opposite to that advocated by Bell Atlantic, which would have all broadband costs treated as telephony with only incremental costs charged to video dialtone.

The Connecticut Department of Public Utility Control ("CDPUC") also has recognized that allocation methodologies in which the bulk of common costs are assigned to telephone service are unreasonable. The Connecticut decision involved the Southern New England Telephone Company ("SNET") intrastate video dialtone application where SNET proposed allocating system costs according to the number of actual video dialtone and telephony customers, a proposal that clearly allocates the bulk of system costs to telephone ratepayers. The CDPUC stated that:

> In the Department's view, the Company's proposed . . . cost allocation will lead to basic telephone service subscribers bearing most of these costs, based on allocation and direct assignment techniques that have little relationship to the reasons why these costs were incurred. For example, allocating costs on a subscriber basis or fiber cable basis for new video services inaccurately reflects the way the network will be used. The number of video service subscribers has only minimal impact on the Company's total . . . costs; however, SNET proposes allocating joint costs based on the number of subscribers. . . . Similarly, the allocation of many of the . . . direct costs based on the number of fibers dedicated to a service category is equally without a rational basis. . . . Moreover, the allocation of costs based simply on the number of fibers dedicated to services fails to recognize that . . . the entire benefit of the cable is the additional added capacity and this high capacity is not needed for basic voice communications.[61/]

While the CDPUC did not adopt a video dialtone cost allocation method,[62/] it firmly rejected all methods that allocate the bulk of common costs to telephone ratepayers as well as the notion that

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61/ State of Connecticut, Department of Public Utility Control, Application of the Southern New England Telephone Company for Approval to Conduct a Dial Tone Transport and Switching Market Trial, Decision, Docket No. 95-03-10 (released June 30, 1995) at 12 (emphasis added).

62/ The CDPUC allowed SNET to conduct a video dialtone trial, but stated flatly that SNET's proposed cost allocation methods "are not acceptable for a commercial offering." Id. at 1-2.

video dialtone costs should be passed to telephone ratepayers because of purported system upgrade "benefits" to telephony that the video dialtone system might provide.

These two decisions provide the Commission with examples of perfectly reasonable methodologies for the allocation of video dialtone common costs. Bell Atlantic ignores them in its Direct Case and rails against the issue designated by the Commission on the 50/50 cost allocation. Bell Atlantic offers no basis why the Commission should reasonably conclude that the CRTC and the CDPUC are incorrect in their determination that the bulk of video dialtone system costs should be allocated to video dialtone system users, nor why the Commission should jettison a 50/50 allocation.

V. BELL ATLANTIC'S PROPOSED OVERHEAD LOADING FACTOR IS UNREASONABLE BECAUSE IT FAILS TO REFLECT THE INCREASE IN OVERHEAD COSTS ATTRIBUTABLE TO VIDEO DIALTONE.

In the Video Dialtone Reconsideration Order, the Commission stated that it would require a strong justification for extremely low overhead allocations.[63/] In the Suspension Order, the Commission found that Bell Atlantic's overall overhead loading factor of 1.2 (i.e., 20 cents of overhead for each dollar of video dialtone investment) and its 1.06 loading factor for term and volume discounts were low enough to warrant investigation.[64/] Issue E of the Investigation Order requests that Bell Atlantic justify its overall loading factor, and Issue F requires a justification for the loading applicable to term and volume discounts.

63/ Video Dialtone Reconsideration Order, 10 FCC Rcd at 346.

64/ Suspension Order at ¶ 48.

In its Direct Case, Bell Atlantic has not provided the information needed to support its extremely low overhead allocation. As an initial matter, Bell Atlantic's claim that it will recover 20 percent of overhead is erroneous. Projected revenues from video dialtone under Bell Atlantic's latest demand projections would make only an 11 percent contribution to overhead.[65/]

Even if the Commission does not require a more accurate allocation of direct costs, there is no basis for permitting the unreasonably low overhead loading of 11 percent. As described below, Bell Atlantic's proposal fails to reflect additional overhead costs generated by video dialtone and attempts to shift these costs to captive customers of non-competitive telephone services, including services critical to the provision of local telephone competition such as interconnection. This proposal is particularly egregious because most channels on the Dover system will be sold to two large packagers at discounted rates, which means that the minimal amount of overhead that video dialtone does recover is at the expense of smaller programmers. The Commission cannot countenance this blatantly anticompetitive approach and must instead require Bell Atlantic to recover at least its average level of overhead.

A. Bell Atlantic's Proposed Overhead Loading Does Not Reflect the Fact that Overhead Cost Are Variable, Not Fixed.

In its Direct Case, Bell Atlantic once again repeats its expert's statement that "customers of other telephone services are by definition better off with any contribution to overhead borne by this new service."[66/] By requiring LEC video dialtone tariffs to

65/ See Exhibit 5.

66/ Direct Case at 62, n.54, citing the Reply Affidavit of Dr. William E. Taylor.

demonstrate a reasonable recovery of overhead, and by investigating the lawfulness of this tariff, the Commission already has rejected this assertion. Telephone customers are not better off with any contribution to overhead borne by video dialtone. Rather, telephone customers are better off only if video dialtone recovers the overhead expense generated by Bell Atlantic's decision to provide video dialtone.

Just as Bell Atlantic equates dedicated equipment costs with incremental costs, it equates overhead costs with fixed costs. If overhead costs were fixed, that is, unchanged in spite of increases in direct costs, the failure of video dialtone revenues to cover overhead costs would not be a matter of substantial concern. But overhead costs are variable, not fixed. Exhibit 6 shows the results of a regression analysis performed on the Uniform System of Accounts expense categories which include "overhead costs". The analysis examines the relationship between Network Operations, Customer Operations, and Corporate Operations expenses to Total Plant In Service ("TPIS") before amortizable assets for all 54 LECs required to file information with the Commission in 1994.[67/] This analysis confirms the direct variability of overhead costs to plant costs for the LECs.

In the case of video dialtone, this relationship is perfectly logical. It would be impossible to build and operate an entirely new digital network without incurring additional overhead expense. While some of these new overhead costs may be attributable to both telephone and video services, many are a direct result of Bell Atlantic's decision to provide video dialtone. For example, Bell Atlantic acknowledges that start-up costs for video

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65/ See Federal Communications Commission, Statistics of Communications Common Carriers, Table 2.9 (1993/1994 edition).

dialtone were not directly assigned to Dover, but instead are included in general overhead.[68/] Unless customers of Bell Atlantic's video service bear this additional overhead expense, telephone customers most definitely will not be better off than they would be if video dialtone were not offered.

B. Bell Atlantic's Proposed Overhead Loading Does Not Reflect the Fact that Video Dialtone Will Incur More Overhead than a New Telephone Service.

As shown above, an addition of video dialtone investments and direct expenses is certain to cause at least a proportionate increase in each category of overhead costs. In all likelihood, however, this understates the actual overhead that will be generated by video dialtone. There is good reason to believe that video dialtone service will cause a proportionately greater increase in overhead costs than a new telephone service. An examination of some of the categories of overhead costs listed by Bell Atlantic on Workpaper 5-18 bears this out:

1. Network Operations expenses include power, administration, testing and engineering. An entirely new service such as video dialtone is virtually certain to incur more of these types of expenses per dollar of direct cost than the average telephony service, which employs established technologies and operating systems.

2. Customer Operations will certainly be greater for a service that is new to both Bell Atlantic and its customers. The development of new marketing plans, organizations, and operations and new customer service relationships will incur expenses proportionately greater for video dialtone than for established telephone services. Bell Atlantic's claim that

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68/ Direct Case at 61.

marketing video dialtone will be no different than marketing a new access service to IXCs ignores important differences between the two types of services.

3. Corporate Operations expenses include executive, planning, accounting, external relations, human resources, information management, legal, procurement and research and development functions. The newness and uniqueness of video dialtone service make it likely that these expenses will increase at a greater rate than for a new telephone service. Bell Atlantic is already incurring significant expenditures in support of video dialtone planning, external relations, legal and research and development work. Once video dialtone becomes operational, Bell Atlantic will have to develop new accounting, information management and procurement systems.

Bell Atlantic's argument that any substantial additional costs that might be incurred would be treated as direct costs of providing video dialtone, rather than overhead, is unconvincing.[69/] Bell Atlantic states in D(6) that "start-up costs are appropriately recovered through overheads cumulatively applied to all services."[70/] Indeed, while Bell Atlantic acknowledges in D(4) and D(5) that there are costs attributable to video dialtone, it proposes to treat these costs as general overhead (allocable to telephone services) because they are not specifically identified with Dover. For example, even though video dialtone is an entirely new service for Bell Atlantic, it identifies only $19.37 for Research and Development and $19.37 for Planning as direct expenses.[71/] This is plainly ludicrous. Given Bell Atlantic's

69/ Direct Case at 63.

70/ Id. at 61.

71/ Direct Case, Attachment D(3) at 1.

desire to place as many costs as possible in overhead, rather than assigning them directly, the Commission must require a greater allocation of overhead to video dialtone than the meager 11 percent proposed here.

It is apparent that Bell Atlantic's unreasonably low overhead loading is strategically motivated. Bell Atlantic's attempt to include the bare minimum of overhead in video dialtone rates stands in stark contrast to its attempt to price expanded interconnection service at fully allocated cost.[72] By classifying video dialtone start-up costs as general overhead, and then allocating only 11 percent of those costs to video dialtone, Bell Atlantic is attempting to shift the costs of its network rebuild to telephone customers and potential competitors. The Commission must reject this blatantly anticompetitive proposal.

VI. BELL ATLANTIC'S VIDEO DIALTONE SERVICE IS PLAINLY UNREASONABLE AND UNLAWFUL.

In the Video Dialtone Reconsideration Order, the Commission established clear standards for LEC video dialtone tariffs. The Commission found that stringent application of the price cap new services test was necessary to counter the LECs obvious incentive to price video dialtone at artificially low rates.[73] Cox has demonstrated that Bell Atlantic failed to satisfy the new services test. As a result of the Commission's investigation, Bell Atlantic must be required to charge a rate that reflects a reasonable sharing of common costs and a less strategically motivated overhead. Specifically, the Commission should require Bell Atlantic to recover at least 50 percent of its network rebuild costs from video services.

72/ See Ameritech Operating Companies, 10 FCC Rcd at 1970-76.

73/ Video Dialtone Reconsideration Order, 10 FCC Rcd at 340.

A. The Precedential Nature of this Decision Requires Strict Adherence to the Standards Established by the Commission in the Video Dialtone Reconsideration Order.

The Commission explicitly recognized in the Video Dialtone Reconsideration Order that "LECs may have an incentive to understate the direct costs of the service in order to set unreasonably low prices and engage in cross-subsidization."[74/] To limit this potential for anticompetitive pricing of video dialtone, the Commission required LECs to demonstrate that their video dialtone tariff filings satisfied the price cap new services test. Under this test, the revenues produced at the proposed rates must recover direct costs (including a reasonable portion of shared or common costs) plus a reasonable portion of overhead.

This proceeding presents the Commission with its first opportunity to apply the new services test to a commercial video dialtone offering. Failure to require Bell Atlantic to prescribe reasonable overheads will lead to even more egregious abuses in future tariff filings. If the Commission accepts an allocation of 72 percent of common costs to telephone services in this case, will it be able to reject a tariff that seeks to place 80 percent of costs on telephone customers? What about 85 or 90 percent, as proposed by some carriers?[75/] The Commission cannot look at Dover in a vacuum without considering the substantial impact this decision will have on future LEC allocation proposals.

The Commission did not establish specific standards by which the reasonableness of LEC cost allocations would be judged, but under any standard it is plain that Bell Atlantic

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74/ Video Dialtone Reconsideration Order, 10 FCC Rcd at 344.

75/ See, e.g., The Southern New England Telephone Company Tariff F.C.C. No. 40, Transmittal No. 652 (filed June 27, 1995).

has not demonstrated that its proposal is reasonable. Exhibit 1 shows the effect of applying Bell Atlantic's average overhead loading factor of 64 percent to the direct costs developed according to the 50/50 allocation method. The unit costs are as provided by Bell Atlantic under these assumptions.[76/] Exhibit 1 indicates that a rate increase of 53 percent is required for Bell Atlantic to cover its direct costs and average overhead.

Exhibit 1 also shows that, if Bell Atlantic is not required to raise its video dialtone rates to cover its costs, it will lose nearly $7 million per year on this 38,000 homes passed venture. Exhibit 4 demonstrates that this loss would mushroom to over $600 million per year if extended to all locations for which Bell Atlantic originally filed Section 214 Applications and over $2 billion annually if extended to all Bell Atlantic households.

Bell Atlantic argues in the Rider Declaration that it would lose all its customers for the Dover video dialtone service if it were forced to charge these higher rates. In support of this position Bell Atlantic includes an elasticity analysis, but Bell Atlantic's elasticity analysis provides no reason not to require Bell Atlantic to charge a higher rate for its Dover video dialtone service.[77/] Principally, the programmer demand for channels may be relatively inelastic. Indeed, the Commission chose to regulate LECs as dominant carriers when they provide video dialtone, notwithstanding that video dialtone programmers will compete with cable, DBS and other video delivery systems. Because the Dover system is the first

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76/ Direct Case Attachment C(3).

77/ Direct Case, Declaration of Robert J. Rider ("Rider Declaration") at 7. It should be noted that under the Video Dialtone Reconsideration Order, an elasticity analysis is supposed to be filed and reviewed with the tariff. Bell Atlantic, however, chose to present this analysis for the first time in its Direct Case.

commercial video dialtone system, the elasticity analysis provided by Bell Atlantic is wholly speculative and cannot be used to support a relaxation of the new services test in this investigation. The only facts behind the analysis are "discussions with existing and potential programmer customers,"[78] and it is hardly surprising that programmer customers would tell Bell Atlantic that demand will drop if prices are raised. Programmers obviously realize that the best way to ensure that Bell Atlantic is permitted to offer the below-cost rates it proposed is create the impression that the service is not viable at higher rates.[79]

The elasticity of programmer demand for channels has yet to be demonstrated. Accordingly, rather than accept at face value the speculative analysis contained in the Rider Declaration, the Commission instead should use Dover as a test of programmer demand.

B. An Easily Administered and More Reasonable Approach to Cost Allocation Is the Cox 50/50 Proposal.

The only way the Commission can avoid the slippery slope created by accepting Bell Atlantic's proposed cost allocation is to prescribe how LECs should allocate the costs of network rebuilds necessary to provide video services. An easily administered approach that has been proposed by Cox is to allocate 50 percent or more of LEC network rebuild costs to video and up to 50 percent to telephone services.[80] Part 64 and Part 36 rules then would be

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78/ Rider Declaration at 5.

79/ As Bell Atlantic moves out of its traditional monopoly service line of business it must realize that in competitive markets, not all business decisions work out. Cox and other cable operators cannot go to the Commission and ask for higher cable rates if a cable investment turns sour. Similarly, the Commission should not allow Bell Atlantic to cry that its Dover investment is not viable absent cross-subsidy.

80/ See Letter to William F. Caton, Acting Secretary, Federal Communications Commission, from Laura H. Phillips, Esq., CC Docket Nos. 87-266 and 94-1 (filed July 12,

(continued...)

applied to each portion of the investment in order to separate nonregulated and intrastate costs. Under this proposal, telephone and video costs would be clearly distinguished and state regulators would have the tools to determine which intrastate costs should be disallowed for telephone ratemaking purposes.

Significantly, the Cox proposal minimizes the present disparity between the accounting treatment of LEC Title II video dialtone services and LEC Title VI cable systems. Under the current rules, a LEC can assign a greater portion of network rebuild costs to telephone services if it offers Title II video dialtone rather than Title VI cable service because cable service is treated as a nonregulated service and thus is subject to fully distributed cost treatment under the Part 64 cost allocation rules. By contrast, under the new services test, a LEC can assign to Title II video dialtone the "incremental" cost of the facility. Given the Commission's goal of ensuring that telephone ratepayers do not foot the bill for LEC network rebuilds necessary for video services, the accounting treatment of LEC network rebuilds should be the same regardless of the regulatory model under which service is provided.[81/] The Cox proposal would achieve this goal in a manner that minimizes the administrative burden of the current system in which

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80/ (...continued)
1995).

81/ This analysis applies only to integrated video/telephone facilities. If a LEC constructs a stand-alone cable system, none of the costs should be borne by telephone ratepayers. Indeed, telephone ratepayers should be compensated for any use of the telephone network by the stand-alone cable system (e.g., use of pole attachments and conduit). See Telephone Company-Cable Television Cross-Ownership Rules, CC Docket No. 87-266, Petition for Clarification or Reconsideration of Cox Enterprises, Inc. and Comcast Cable Communications, Inc. (filed September 25, 1995) (seeking confirmation that all costs of a stand-alone cable system will be treated as non-regulated under Part 64 rules and that cable operators will be afforded access to poles and conduit on the same terms as LECs provide themselves).

the Commission must monitor on a case-by-case basis the varied allocation procedures employed by the LECs.

Allocating LEC network rebuild costs on a 50/50 basis is a fair compromise between the Commission's desire to spur investment and its duty to prevent cross-subsidization. As described above, the broadband facilities proposed by LECs for video dialtone are not necessary for the provision of telephone service and the Commission would be wholly justified if it determined that all broadband costs should be presumptively assigned to video.[82/] Bell Atlantic, on the other hand, argues that video dialtone will not be economically feasible unless the lion's share of the costs are assigned to telephone services. The 50/50 proposal is a simple, reasonable compromise between these two competing positions.

VII. CONCLUSION.

Bell Atlantic made a bad business decision in Dover. No amount of cost misallocation can bring back the money that has already been spent on a video dialtone system that Bell Atlantic's own figures show is not economically viable -- the only question now is who must pay for an investment gone sour. Bell Atlantic's Dover tariff makes clear that Bell Atlantic intends to recover its bad investment from innocent parties such as employees, competitors and ratepayers, rather than recovering its costs from video dialtone customers and Bell Atlantic shareholders as Bell Atlantic has promised.

The precedential effect of the Dover investigation is plain. The Commission can either choose to prop up a poor investment, thereby giving other LECs an incentive to play

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82/ As discussed above, the Canadian Radio-television and Telecommunications Commission recently adopted this type of proposal.

similar big-money shifting games, or it can establish reasonable cost allocation policies that prevent LECs from foisting the costs of their video dialtone systems on defenseless telephone ratepayers, Bell Atlantic employees, and telephony competitors. The Commission must do what it should have done all along -- decide a fair allocation method and require all LEC investments to be measured by the same yardstick.

Respectfully submitted,

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November 30, 1995

Updated Demand
50/50 Cost Allocation
Average Overhead

DOVER
VIDEO DIALTONE SERVICE
RECURRING REVENUE IMPACT

UNIT COST - TOTAL COSTS

RATE ELEMENT		ANNUAL DEMAND (a)	UNIT COST (b)	MONTHLY RATE (c)	ANNUAL COST (d)	ANNUAL REVENUE (e)
VIDEO DIALTONE ACCESS LINKS						
(Up to 96 Mbps MPEG2 Channels)						
DIRECT ACCESS CONNECTION						
Termination		48	$1,206.67	$900.00	$57,920.16	$43,200.00
Fixed		48	$738.83	$500.00	$35,463.84	$24,000.00
Per Mile		480	$13.76	$12.00	$6,604.80	$5,760.00
SERVING WIRE CENTER CONNECTION						
Fixed		12	$1,463.51	$1,000.00	$17,562.12	$12,000.00
Per Mile		120	$13.76	$12.00	$1,651.20	$1,440.00
BROADCAST SERVICE	CHAN.					
INDIVIDUAL BROADCAST CHANNELS						
Per Channel Per Pot Sub. - Monthly	7	84	$0.0846	$0.050	$272,310.14	$160,939.80
Per Channel Per Pot Sub. - 5 Year	18	216	$0.0846	$0.045	$700,226.08	$372,460.68
GROUP OF 24 BROADCAST CHANNELS						
Per Channel Per Pot Sub. - Monthly	48	24	$2.03	$1.10	$1,866,901.68	$1,011,621.60
Per Channel Per Pot Sub. - 5 Year	264	132	$2.03	$0.90	$10,267,959.24	$4,552,297.20
NARROWCAST SERVICE						
INDIVIDUAL NARROWCAST CHANNELS						
Per Channel Per Pot Sub.	0	0	$0.0847	$0.08	$0.00	$0.00

	337					
TOTAL:					$13,226,599.26	$6,183,719.28
NET REVENUE:						($7,042,879.98)
NET REVENUE/TOTAL COST:						-53%
OPTIONAL FEATURE						
(Available with Broadcast and Narrowcast Channels)						
MESSAGING PORTS		360	$414.29	$325.00	$149,144.40	$117,000.00
GRAND TOTAL:					$13,375,743.66	$6,300,719.28
NET REVENUE:						($7,075,024.38)
NET REVENUE/TOTAL COST:						-53%

Potential Broadcast Subscribers:	38,319
Narrowcast Service Percentage:	0.00%
Potential Narrowcast Subscribers:	0

Replication of Bell Atlantic Workpaper 5-19, Revised As Follows:

Col. (a) = Year 3 Demand Per Bell Atlantic Attachment Pre (3)
Col. (b) = Fully Allocated Costs Per Bell Atlantic Workpapers 5-1, 5-2, 5-12 and Attach. C (3)

Exhibit 2

Updated Demand
50/50 Cost Allocation

DOVER
VIDEO DIALTONE SERVICE
RECURRING REVENUE IMPACT

UNIT COST - DIRECT COSTS ONLY (337 CHANNELS)

RATE ELEMENT		**ANNUAL DEMAND** (a)	**UNIT COST** (b)	**MONTHLY RATE** (c)	**ANNUAL COST** (d)	**ANNUAL REVENUE** (e)
VIDEO DIALTONE ACCESS LINKS						
(Up to 96 Mbps MPEG2 Channels)						
DIRECT ACCESS CONNECTION						
Termination		48	$735.55	$900.00	$35,306.40	$43,200.00
Fixed		48	$450.37	$500.00	$21,617.76	$24,000.00
Per Mile		480	$8.39	$12.00	$4,027.20	$5,760.00
SERVING WIRE CENTER CONNECTION						
Fixed		12	$892.11	$1,000.00	$10,705.32	$12,000.00
Per Mile		120	$8.39	$12.00	$1,006.80	$1,440.00
BROADCAST SERVICE	**CHAN.**					
INDIVIDUAL BROADCAST CHANNELS						
Per Channel Per Pot Sub. - Monthly	7	84	$0.0516	$0.050	$166,089.87	$160,939.80
Per Channel Per Pot Sub. - 5 Year	18	216	$0.0516	$0.045	$427,088.25	$372,460.68
GROUP OF 24 BROADCAST CHANNELS						
Per Channel Per Pot Sub. - Monthly	48	24	$1.24	$1.10	$1,140,373.44	$1,011,621.60
Per Channel Per Pot Sub. - 5 Year	264	132	$1.24	$0.90	$6,272,053.92	$4,552,297.20
NARROWCAST SERVICE						
INDIVIDUAL NARROWCAST CHANNELS						
Per Channel Per Pot Sub.	0	0	$0.0589	$0.08	$0.00	$0.00

	337					
TOTAL:					$8,078,268.96	$6,183,719.28
NET REVENUE:						($1,894,549.68)
NET REVENUE/TOTAL COST:						-23%
OPTIONAL FEATURE						
(Available with Broadcast and Narrowcast Channels)						
MESSAGING PORTS		360	$252.54	$325.00	$90,914.40	$117,000.00
GRAND TOTAL:					$8,169,183.36	$6,300,719.28
NET REVENUE:						($1,868,464.08)
NET REVENUE/TOTAL COST:						-23%

Potential Broadcast Subscribers:	38,319
Narrowcast Service Percentage:	0.00%
Potential Narrowcast Subscribers:	*0*

Replication of Bell Atlantic Workpaper 5-19, Revised As Follows:

Col. (a) = Year 3 Demand Per Bell Atlantic Attachment Pre (3)

Col. (b) = Direct Costs for Broadcast and Narrowcast Per Bell Atlantic Attach. C (3)

Exhibit 3

<u>Incremental Cost Analysis</u>
(Network Investment per Home)

1.	Integrated Network	$1,222
2.	Stand-Alone Video	1,017
3.	Stand-Alone Telephone	696
4.	Incremental Video (L1 - L3)	526
5.	Incremental Telephone (L1 - L2)	205
6.	Incremental Total (L4 + L5)	731
7.	Common Cost	491
8.	Percent Incremental Video to Total Incremental (L4/L6)	72%

Source: <u>Residential Fiber Optic Networks, An Engineering and Economic Analysis</u>, David P. Reed, Artec House, 1992.

Line 1: Table B8, pp. 300-301.
Line 2: Table B18, pp. 320-321.
Line 3: Table B2, pp. 288-289.

DOVER
VIDEO DIALTONE SERVICE

Extrapolation of Losses
($000)

	Location	Homes Passed (a)	Loss (b)
1.	Dover (WPC - 6840)	38,319	$7,075
2.	Floram Park (WPC - 6838)	11,700	$2,160
3.	Washington (WPC - 6912)	1,246,925	$230,225
4.	Five City (WPC - 6966)	1,965,557	$362,909
5.	All Applications (L1 +L2 +L3 +L4)	3,262,182	$602,311
6.	All Households	11,400,000	$2,104,831

Note: Column (b), Lines 2 - 6, = Column (a) x [Column (b), Line 1 / Column (a), Line 1].

Exhibit 5

Updated Demand

DOVER
VIDEO DIALTONE SERVICE
RECURRING REVENUE IMPACT

UNIT COST - DIRECT COSTS ONLY (337 CHANNELS)

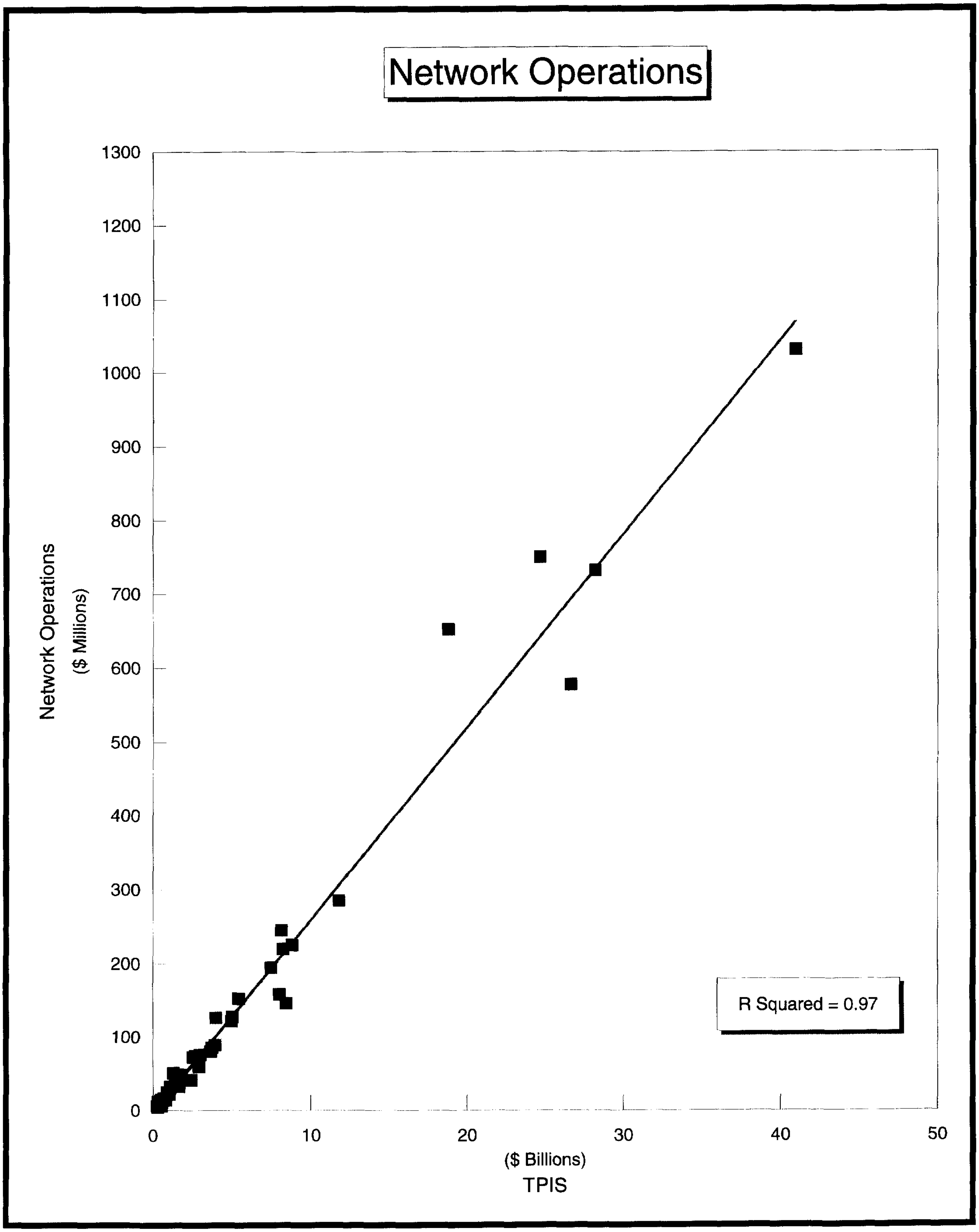
RATE ELEMENT	CHAN.	ANNUAL DEMAND (a)	UNIT COST (b)	MONTHLY RATE (c)	ANNUAL COST (d)	ANNUAL REVENUE (e)
VIDEO DIALTONE ACCESS LINKS (Up to 96 Mbps MPEG2 Channels)						
DIRECT ACCESS CONNECTION						
Termination		48	$735.55	$900.00	$35,306.40	$43,200.00
Fixed		48	$450.37	$500.00	$21,617.76	$24,000.00
Per Mile		480	$8.39	$12.00	$4,027.20	$5,760.00
SERVING WIRE CENTER CONNECTION						
Fixed		12	$892.11	$1,000.00	$10,705.32	$12,000.00
Per Mile		120	$8.39	$12.00	$1,006.80	$1,440.00
BROADCAST SERVICE						
INDIVIDUAL BROADCAST CHANNELS						
Per Channel Per Pot Sub. - Monthly	7	84	$0.0354	$0.050	$113,945.38	$160,939.80
Per Channel Per Pot Sub. - 5 Year	18	216	$0.0354	$0.045	$293,002.40	$372,460.68
GROUP OF 24 BROADCAST CHANNELS						
Per Channel Per Pot Sub. - Monthly	48	24	$0.85	$1.10	$781,707.60	$1,011,621.60
Per Channel Per Pot Sub. - 5 Year	264	132	$0.85	$0.90	$4,299,391.80	$4,552,297.20
NARROWCAST SERVICE						
INDIVIDUAL NARROWCAST CHANNELS						
Per Channel Per Pot Sub.	0	0	$0.0589	$0.08	$0.00	$0.00

	337					
TOTAL:					$5,560,710.66	$6,183,719.28
NET REVENUE:						$623,008.62
NET REVENUE/TOTAL COST:						11%
OPTIONAL FEATURE (Available with Broadcast and Narrowcast Channels)						
MESSAGING PORTS		360	$252.54	$325.00	$90,914.40	$117,000.00
GRAND TOTAL:					$5,651,625.06	$6,300,719.28
NET REVENUE:						$649,094.22
NET REVENUE/TOTAL COST:						11%

Potential Broadcast Subscribers:	38,319
Narrowcast Service Percentage:	0.00%
Potential Narrowcast Subscribers:	0

Replication of Bell Atlantic Workpaper 5-19, Revised As Follows:

Col. (a) = Year 3 Demand Per Bell Atlantic Attachment Pre (3)


Network Operations
1300
1200
1100
1000
900
800
700
600
500
400
300
200
100
0
Network Operations
($ Millions)
0
10
20
30
40
50
($ Billions)
TPIS
R Squared = 0.97